No. 20991

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MARVIN B. KAPELUS and CRENSHAW CARPET CENTER, INC.,

Appellants,

vs.

A JOINT VENTURE OR COPARTNERSHIP composed of JOSEPH J. FRANKLIN, also known as J. J. FRANKLIN, LEATRICE FRANKLIN and FLORENCE FITZGERALD, also known as FLORENCE JAMES, as Joint Venturers or Copartners, and JOSEPH J. FRANKLIN, also known as J. J. FRANKLIN, LEATRICE FRANKLIN and FLORENCE FITZGERALD, also known as FLORENCE JAMES, individually,

Appellees.

APPELLANTS' OPENING BRIEF.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

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APPELLANTS' OPENING BRIEF.

Jurisdictional Basis.

This is an appeal from a final judgment made and entered in the United States District Court for the Southern District of California, and it is prosecuted in accordance with the provisions of Rule 72 *et seq.* of the Federal Rules of Civil Procedure in the United States District Court.

On August 26, 1964, Joseph J. Franklin *et al.*, the Debtors and Appellees herein, filed their Petition and

schedules in the U.S. District Court under Chapter XI of the Bankruptcy Act.

On September 8, 1964, the Debtors filed with Robert B. Powell, Referee in Bankruptcy, an Application to Stay State Court Action [Clk. Tr. p. 2].

On September 8, 1964, Robert B. Powell, Referee in Bankruptcy, issued an Order to Show Cause thereon with Temporary Restraining Order [Clk. Tr. p. 12].

On September 15, 1964 Marvin B. Kapelus and Crenshaw Carpet Center, Inc., Appellants, filed their Answer to the Debtors' Application for Order to Show Cause [Clk. Tr. p. 14].

On October 5, 1964 Robert B. Powell, Referee in Bankruptcy, issued an Order restraining Appellants from proceeding with their Cross-Complaint in the state court action until further Order of the Bankruptcy Court [Clk. Tr. p. 20].

On October 30, 1964 Marvin B. Kapelus and Crenshaw Carpet Center, Inc. filed their Application for Reconsideration and to Vacate the Order of October 5, 1964 [Clk. Tr. p. 36].

On October 30, 1964 Robert B. Powell, Referee in Bankruptcy, issued an Order to Show Cause thereon [Clk. Tr. p. 22].

On November 14, 1964 the Debtors filed their Answer to Appellants' Application for Reconsideration and to Vacate the Order of October 5, 1964 [Clk. Tr. p. 31].

On November 3, 1964 the Debtors filed their Application to Quiet Title to Real Property and in the Alternative to Set Aside Fraudulent Transfer [Clk. Tr. p. 40].

On November 3, 1964 Robert B. Powell, Referee in Bankruptcy, issued an Order to Show Cause thereon [Clk. Tr. p. 57].

On November 17, 1964 Marvin B. Kapelus and Crenshaw Carpet Center, Inc. filed their Response to the said Application and Order to Show Cause and Objection to Summary Jurisdiction of the Bankruptcy Court [Clk. Tr. p. 59].

Between the dates of December 10, 1964 and January 18, 1965, before Herschel E. Champlin, Referee in Bankruptcy, a joint trial was held on the Appellants' Application for Reconsideration and to Vacate Restraining Order and on the Debtors' Application to Quiet Title to Real Property and in the Alternative to Set Aside Fraudulent Transfer.

On March 2, 1965 the Debtors filed their Application and Notice to Tax Costs in Favor of Debtors [Clk. Tr. p. 24].

On March 29, 1965 Herschel B. Champlin, Referee in Bankruptcy, filed his Findings of Fact and Conclusions of Law, which were dated March 12, 1965 [Clk. Tr. p. 89].

On March 29, 1965 Herschel B. Champlin, Referee in Bankruptcy, filed his Order Decreeing Deed to be a Mortgage, and Taxing Costs Against Appellants, which Order was dated March 12, 1965 [Clk. Tr. p. 121].

On February 28, 1966 Herschel B. Champlin, Referee in Bankruptcy, entered his Order Nunc Pro Tunc correcting the Order of March 12, 1965 [Clk. Tr. p. 145].

On April 9, 1965 Appellants filed their Petition for Review from the Referee's Order of March 29, 1965 [Clk. Tr. p. 130].

On August 9, 1965 Herschel B. Champlin, Referee in Bankruptcy, filed his Certificate on Review of Order of March 12, 1965, along with a Supplemental Certificate on Review by Robert B. Powell, Referee in Bankruptcy [Clk. Tr. pp. 136, 143].

On February 21, 1966 a hearing was held before the Honorable Charles H. Carr, Judge on the United States Court for the Southern District of California, on the basis of the record and Points and Authorities submitted by both sides.

On March 2, 1966 the Honorable Charles H. Carr entered his Order denying Appellants' Petition for Review and also denying the Appellees' Cross-Petition for Review and affirming the Referee's Orders of March 12, 1965 and April 15, 1965 [Clk. Tr. p. 151].

On March 21, 1966 the Appellants, Crenshaw Carpet Center, Inc. and Marvin B. Kapelus filed their Notice of Appeal to this Court [Clk. Tr. p. 154].

Statement of the Case.

Appellant, Crenshaw Carpet Center, in 1962, sold carpet to the Appellee Debtor, Franklin. Said Debtor thereafter failed to pay the indebtedness as agreed, and Crenshaw, through its attorney, Appellant Kapelus, obtained a judgment in the sum of $9,461.81 and proceeded to enforce collection by legal means [Rep. Tr. Vol. I, pp. 87-91]. Thereafter, through a series of transactions with Franklin, Crenshaw Carpet and Kapelus took title, by foreclosing a second trust deed, to an apartment building in the County of Orange, which the Debtors claim had been owned by them, although the title thereto had been in one Curtis W. Reedy [Rep. Tr. Vol. I, p. 102, to Vol. II, p. 155].

Franklin, being desirous of obtaining, or regaining, title to said apartment building, at first offered to exchange therefor second trust deeds on certain property also in the County of Orange. Crenshaw and Kapelus refused this exchange, declining to accept any further trust deeds from the Debtor. Whereupon, in September, 1964, at Franklin's request, the said Reedy entered into an escrow with Crenshaw and Kapelus whereby the latter parties conveyed their title in the aforesaid apartment building to Reedy, and Reedy conveyed to Crenshaw and Kapelus his title to certain unimproved real property, which is the subject of these proceedings [Rep. Tr. Vol. II, p. 242, to Vol. III, p. 335].

As a condition of the exchange, Crenshaw and Kapelus granted to the said Reedy a written option to purchase back the unimproved property for the sum of $20,500.00 on or before a date in January, 1964, under specific terms and conditions (Debtors' 33). Said exchange of properties was handled through a formal escrow and a policy of title insurance on the unimproved real property was issued to Crenshaw and Kapelus by a title company [Rep. Tr. Vol. X, p. 1155, to p. 1160]. At the request of the title company, the transferor, Reedy, executed a document guaranteeing the transfer to Crenshaw and Kapelus as an absolute conveyance and as an absolute transfer of title and possession to Crenshaw and Kapelus [Resp. Ex. 2].

Testimony has been submitted by the Debtors, and the Referee has found as a fact, that at the time of the transfer, this property was actually the property of the Debtors herein, and that the transferror and previous record owner, Reedy, was holding title only for the benefit of the Debtors [Find. 29, Clk. Tr. p. 89].

The Debtor, Franklin, has further testified that Reedy transferred title to Crenshaw and Kapelus at his request and the document guaranteeing this as a complete transfer of title and possession was executed by the said Reedy at the request and instruction of the Debtor Franklin [Rep. Tr. Vol. IV, p. 426, lines 13-22].

Reedy and/or the Debtor Franklin attempted to exercise the option of January 21, 1964. Crenshaw and Kapelus refused to accept, alleging various breaches of the terms of the said option [Rep. Tr. Vol. XI, pp. 613-626 and pp. 650-670].

The property involved has at all times remained vacant unimproved land, and the record title to the property has remained in Crenshaw and Kapelus since October 10, 1963, when conveyed to them by Reedy [Resp. Ex. 1 and Rep. Tr. Vol. I, p. 15, lines 13-18; p. 21, line 26, to p. 22, line 11].

On or about January 24, 1964, Reedy and the Debtors herein filed an action in the Superior Court of the State of California in and for the County of Orange against Crenshaw Carpet Center, Inc. and Marvin B. Kapelus, asking that the deed to Crenshaw and Kapelus be adjudged a mortgage and to quiet title to the property in the plaintiffs [Vol. IV, pp. 449, 450].

Crenshaw and Kapelus filed their Answer and Cross-Complaint for Declaratory Relief to quiet title in the said state court action [Rep. Tr. Vol. XII, p. 1491].

A Pre-Trial conference was held in said state court action in July, 1964, at which time the matter was set for trial on October 6, 1964 [Pre-Trial Conf. Order, Clk. Tr. p. 14].

On August 26, 1964, the Debtors filed their Petition under Chapter XI of the Bankruptcy Act, and in

their schedules alleged that they are the owners of the subject real property.

Pleadings were thereafter filed with the Referee in Bankruptcy and hearings held as set forth above. The combined litigation on the Orders to Show Cause [Clk. Tr. pp. 36 and 40] commenced on December 10, 1964 before Referee Herschel E. Champlin, and on January 13, 1965 after thirteen days of litigation, the Referee ruled that he had summary jurisdiction to hear the matters before him [Rep. Tr. Vol. XIV, pp. 1678-1695].

On January 18, 1965, at the next following hearing, the Referee made his oral decision on the case in chief in favor of the Debtors, apparently to the effect that the deed involved held by Appellants was actually a mortgage [Rep. Tr., Vol. XV, p. 1833, line 19, to p. 1838, line 3].

Specification of Errors.

1. The Referee erred in his procedure to determine summary jurisdiction over the matter before him.
2. The Referee erred in assuming summary jurisdiction over the Debtors and their property.
3. The Referee erred in continuing to restrain the pending State Court action between the same parties.
4. The Referee abused his discretion in assuming jurisdiction over the litigation of title to the real property involved.
5. There was insufficient evidence to support the Referee's decision on the merits.
6. On principles of equity, the Appellees were not entitled to relief from the Bankruptcy Court.

ARGUMENT.

It should first be considered that this case is not as complex as the length of the Reporter's Transcript, the record and the list of exhibits might indicate. In essence, it consists of an action filed by a Debtor before a Bankruptcy Referee to recover title to real property previously deeded to Respondents, under a theory that the deed was intended to be a mortgage.

But even before this, it is Appellants' primary contention that the Referee was totally without power to even try the issues over the objections of Appellants.

Should this Court agree with Appellants on this limited issue, then, of course, the volumes of testimony, rulings, exhibits and arguments are for the most part meaningless.

POINT ONE.

The Bankruptcy Court Did Not Have Summary Jurisdiction to Determine the Interest of the Record Owners of the Property.

A. Procedure When Objection Is Raised to Bankruptcy Referee's Summary Jurisdiction.

In all cases where the summary power of the bankruptcy court is disputed, a preliminary inquiry is required to ascertain whether or not the prerequisites of summary jurisdiction are present before the Court can proceed on the merits.

Collier on Bankruptcy, 14th Ed., Vol. 2, Sec. 23.07, pp. 519-620;

In re Gill, 190 Fed. 726, 26 A.B.R. 883 (8th C.C.A. 1911).

The record reflects that on the first day of trial, the attorney for Appellants attempted to acquaint the Referee with his viewpoints and authorities on this limited issue [Rep. Tr. Vol. I, pp. 8, 74], and also contended it must be determined initially and separately from the case in chief.

On the morning of the second day of trial, written Points and Authorities in this regard were submitted to the Referee and served on the opposing parties [Rep. Tr., Vol. II, p. 132; Clk. Tr. p. 76].

Without accepting any further argument or making any comment thereon, the Referee continued to take evidence on the merits of the entire case, apparently under the belief that this was necessary for his determination of whether or not he had jurisdiction to hear the matter. This viewpoint was stated as follows:

> "I don't see how we can make a dent in this problem of jurisdiction until we hear the whole story. Then I think we can consider the stalk from the leaf and get the primary question decided as well as disposal of the other issues as we go along." [Rep. Tr. Vol. I, p. 28, lines 18-23].
>
> "We are reserving our rulings on all of this until we hear the case. We are not supposed to rule on jurisdiction until we hear a lot more of what we have heard so far."
>
> "I am here for the purpose of hearing the whole story." [Rep. Tr. Vol. I, pp. 33, 34].
>
> "We are going to need to hear the whole case before we can even rule on our preliminary issue of jurisdiction." [Rep. Tr. Vol. I, p. 73, lines 25, 26].

"We have to hear the entire case first." [Rep. Tr. Vol. I, p. 75, line 5].

"There is a long sequence of course in the transaction as I view it so far. I don't know what more is coming but it is just another item in the trying of the lawsuit here." [Rep. Tr. Vol. II, p. 164, lines 4-7].

"We have already ruled from the first day of trial that we are going to hear the whole case before we felt as though we could even begin to rule on the question of jurisdiction." [Rep. Tr. Vol. VII, p. 782, lines 13-16].

". . . we ruled at the very beginning that jurisdiction depends on the hearing of the entire case . . ." [Rep. Tr. Vol. X, p. 1196, lines 2 and 3].

Appellants respectfully invite the Court's attention to the fact that on several occasions they attempted to learn from the Referee exactly why he deemed it necessary to try this entire matter before he could determine the question of summary jurisdiction. The only logical interpretation of the Referee's statements and actions is that he believed he would be justified in assuming jurisdiction over this matter if he found some equitable or reversionary interest in the property in the Debtors. This was finally indicated by the Referee in stating his decision on jurisdiction [Rep. Tr. Vol. XIV, pp. 1678-1694].

Appellants strenuously urge that the Referee erred not only in his procedures but in the basis upon which he ultimately determined the issue of jurisdiction.

A Bankruptcy Referee cannot base his jurisdictional power upon his ultimate decision of the case in chief. (*Suhl v. Bumb,* 348 F. 2d 869 (9th C.C.A. 1965).)

B. Requirements for Summary Jurisdiction.

It is undisputed that Appellants are the sole record owners of the real property involved in these proceedings and have been continuously since before the Chapter XI proceedings were filed.

The following authorities are cited for the premise that, under these circumstances alone, there is no summary jurisdiction in the bankruptcy court, when they object thereto and have a substantial adverse claim:

1. *Collier on Bankruptcy,* 14th Ed., Vol. 2, Sec. 23.06, note 4, p. 495.

   "Record owner of real property, not (a) party to (the) bankruptcy proceedings, cannot be brought within bankruptcy court's jurisdiction on a petition of (the) trustee to summarily determine title to property."

2. *In re Black Bear Products* (D.C. Wash.), 56 F. 2d 243.

Claimant Carpenter had record title to real property and bankrupt was buying under a land sale contract, which was in default. Trustee alleged fraud on the part of Carpenter in attempting to foreclose on the property and brought a petition in bankruptcy court to determine title in bankrupt. In denying jurisdiction, the Court stated:

> "Carpenter, being vested with the legal title more than eight months prior to adjudication, and not being a creditor, and therefore not a party to the bankruptcy proceeding, has a right to a full, complete, unabridged procedure and remedy—plenary —in adjudicating her title to the property when it is attacked, and a charge of fraud does not change the procedure."

3. *Wight v. Street* (9th C.C.A.), 63 F. 2d 80.

The bankrupt had deeded the property to the claimant prior to bankruptcy. The trustee brought a petition in bankruptcy court to set aside the transfer, alleging ownership in the bankrupt. The claimant objected to jurisdiction, but the Referee assumed jurisdiction and held the deed was fraudulent in that the transfer was an attempt to hinder and delay creditors. The District Court affirmed but the Ninth Circuit Court reversed, holding the Referee erred in assuming jurisdiction.

4. *Kaplan v. Guttman*, 217 F. 2d 481 (9th C.C.A.).

The Bankruptcy Court had assumed jurisdiction over a controversy involving real property. In reversing the Referee, the late Judge James Alger Fee, at page 484, stated the law as follows:

> "Legal title was in the Kaplan Partnership. Possession follows legal ownership."

5. *In re Mimms and Parham,* 193 Fed. 276.

The bankrupt, prior to bankruptcy, conveyed by deed certain real property to the Respondent. At the same time the Respondent gave an option to the bankrupt to repurchase the land under certain terms and conditions.

It was further provided that the *bankrupt* was to remain in possession of the land—*which he did.*

Thereafter, the petition in bankruptcy was filed, and the Trustee brought proceedings before the Referee to sell the property, free of liens, alleging that the documents described above constituted a mortgage. The Respondent contested the summary jurisdiction of the bankruptcy court (by demurrer).

In denying jurisdiction the Court stated:

> "If the Trustee is not in actual possession, *in the legal sense,* of the estate, and if the (Respondent) asserts an adverse claim to the ownership of the lands and its possession thereof by its tenant, and if that claim is not merely colorable, but is one made in good faith, then, under authorities (citing), it would seem to be clear that the controversy in respect to such claim is one which should not, *and indeed cannot,* be settled in a summary way in this proceeding. On the contrary, the rights of the parties *must be* settled in a plenary suit . . ." (Emphasis added.)

It is, of course, true that the authorities usually look upon *possession* as the criterion in determining summary jurisdiction, but, as indicated by the authorities cited above, this criterion should only be applicable when dealing with *personal* property or at least with property that is susceptible of actual possession.

But at least it can be stated that actual or constructive possession of the subject property by the Debtors is an absolute necessity for summary jurisdiction in the bankruptcy court, when there is no consent by an adverse claimant with a substantial claim.

The property involved in these proceedings, being uninhabited and unimproved, is not susceptible to actual physical possession. We can, therefore, only consider what rights to possession the respective parties may have had and what acts of possession were legally exercised.

And it is the Debtors who have the burden to establish this possession or the right thereto. (*Maule Industries v. Girtstel*, 232 F. 2d at p. 297).

And this burden includes the task of overcoming the presumption that possession is in the Petitioners:

> "In every action for the recovery of real property, or the possession thereof, the person establishing a legal title to the property is presumed to have been possessed thereof within the time required by law, and the occupation of the property by any other person is deemed to have been under and in subordination to the legal title, unless it appear that the property has been held and possessed adversely to such legal title, for five years before the commencement of the action." (Sec. 321, Calif. Code of Civil Procedure).

A careful scrutiny of the record in this case reveals no evidence whatsoever to establish possession, or the right thereto in the Debtors. But the undisputed evidence does show that the grantor of the property, Curtis W. Reedy, executed a document wherein he agreed that "upon recordation of said deed through said escrow, possession of said premises will be surrendered to said grantee" [Resp. Ex. 2]; and further that the Debtor, Franklin, authorized and instructed Reedy to execute this document [Rep. Tr. Vol. IV, p. 429, lines 13-22].

The Referee has signed Findings of Fact to the effect that possession of the subject property has at all times remained in the Debtors, even though they never at any time held record title. Such a finding is simply not supported by the evidence.

The only evidence in the record which the Debtors sought to rely upon was certain testimony by J. J. Franklin and the witness Reedy regarding:

1. Using the property for the storage of trash containers.
2. Authorizing the removal and erection of certain signs on the property.
3. Removing trees from the property.
4. Moving dirt on the property.
5. Paying the taxes on the property.
6. Taking prospective lenders over the property.

A careful reading of the testimony in this regard, particularly the cross-examination thereon, reveals that every one of these contentions is false as regards the specific property and period of time involved. The only possible exception being No. 6 above which is of no probative value whatsoever.

With regard to the contentions enumerated, the Court's attention is respectfully invited to the following portions of testimony, bearing in mind that the property was deeded to Appellants on October 10, 1963, and the Chapter XI proceedings were filed August 26, 1964.

1. The trash containers were actually on an adjoining property [Rep. Tr. Vol. V, pp. 559, 560; Vol. VIII, p. 981].
2. The Debtors did not, after the deed to Appellants, assume any control over the property in regard to signs [Rep. Tr. Vol. IV, p. 448; Vol. V, p. 561].

3. Any trees removed from the property were removed prior to the deed to Appellants or were removed by the city, apparently as a nuisance [Rep. Tr. Vol. IV, pp. 393, 394; Vol. VII, p. 808].
4. Any dirt removal from the property was done prior to the deed to Appellants or was later required but *not done* by the Debtors [Rep. Tr. Vol. IV, p. 396; Vol. VII, pp. 807, 808].
5. The Debtors purported payment of taxes on January 22, 1964 was by a check which was not honored for payment [Rep. Tr. Vol. VIII, p. 899].

It is thus apparent that there is not one iota of evidence in these proceedings to establish any sort of possession, constructive or otherwise, in the Debtors in spite of the false and misleading statements by counsel for the Debtors in his opening statement [Rep. Tr. Vol. I, p. 55, line 10, to p. 57, line 17].

But it is also apparent that in actuality the Referee was not mislead in this respect in spite of the Findings of Fact he signed.

He obviously did not apply the question of possession in deciding the issue of summary jurisdiction. After thirteen days of taking evidence from eighteen witnesses and the admission of one hundred and twenty-six documents, he determined that he had jurisdiction on the theory that

> "At this time the Court finds that the transaction was nothing more than a security transaction." [Rep. Tr. Vol. XIV, p. 1683, lines 18, 19],

and at a later point, the Court stated:

> ". . . we could not conclude otherwise but that it was an unequivocal intent of the parties on both sides that this was to be a security transaction and nothing more." [Rep. Tr. Vol. XIV, p. 1684, lines 19-22].

It is thus evident that the Court's decision as to summary jurisdiction was based on some sort of equitable ownership in the Debtors, and that the respondents were holding the property "as a constructive trust". This is reflected in the transcript at pages 1693 and 1694, Vol. XIV. It is significant that nowhere in the Referee's decision from the Bench is there even a hint that he was concerned with possession of the property, actual or otherwise, and when Appellants' attorney moved the Court to strike all evidence *not* concerning title or possession of the property, this motion was promptly denied [Rep. Tr. Vol. XIII, p. 1528].

The Appellants, however, in addition to the presumption that they as record owners are in possession of the property, have shown that they made payments on the trust deed encumbrance on the property [Rep. Tr. Vol. I, p. 16], authorized use of the property by others [Rep. Tr. Vol. I, pp. 16, 17], and attended City Council and Planning Commission Hearings concerning the property [Rep. Tr. Vol. XII, p. 1479].

POINT TWO.

The Bankruptcy Court Erred in Continuing to Restrain the Pending State Court Action Between the Same Parties.

As indicated in the Statement of Facts above, the *Debtors* first initiated an action in the state court to determine title to the subject property. A Cross-Complaint was filed by Appellants, Pre-Trial Proceedings were held, and a trial date set, all before the Debtors filed their Petition with the Bankruptcy Court.

Section 314 of the Bankruptcy Act may grant to the Referee the power to *enjoin or stay* proceedings pending in the state court, but this is not to say the Referee is empowered to stay the proceedings indefinitely so that he may seize jurisdiction over the litigation pending there.

The Referee's power in this regard must necessarily and logically be limited to the restraining of state court actions for whatever *reasonable* period of time may be necessary to protect the Debtors' assets.

There was no such necessity in the present case whatsoever, excepting only perhaps to permit a Receiver to substitute into the State Court action and file whatever additional cause of action he might deem appropriate.

Bankruptcy Act, Chap. XI, Sec. 314.

POINT THREE.

Even if the Referee Legally Had Power to Assume Jurisdiction, He Abused His Discretion in so Doing.

Even if the legal requirements are present, the Bankruptcy Court should refuse to accept summary jurisdiction when there is a more proper forum for trial.

The 16 volumes of testimony in this case, if nothing else, prove that we are dealing here with an important problem concerning title to real property and the California Law applicable thereto. We are not dealing with any specific problem or remedy to be found within the Bankruptcy Act, but with a matter of proper concern to the California Courts. The primary factual issue to be determined in this controversy is the *intent* of the parties when the real property was transferred, and it is grossly unfair to deprive the Petitioners of their right to have this issue tried before a jury, if they should so desire.

As to courtroom facilities, it is not necessary to go outside the record to point out that the trial facilities in this case did not even include a blackboard or bulletin board on which the property involved could be displayed. A great deal of testimony and explanations were necessary to keep the Court acquainted with the boundaries, etc. of the property. No law library was available to the Referee, should it be necessary, and the witness stand had no shelf or counter for use by the numerous witnesses in examining documents when being questioned. Additionally, there was not even a

clerk available to mark, log and control the 129 documents admitted into evidence [Rep. Tr. Vol. I, p. 38; Vol. XI, p. 1397, lines 10-12; Vol. XIV, p. 1679, line 15, to p. 1680, line 4].

The extreme difficulty encountered by the Referee in keeping track of the various documents and the precise litigation before him is evidenced by the fact that on at least one occasion he believed he was simultaneously hearing litigation on another Order to Show Cause which happened to be on the same calendar throughout this trial. To save a lengthy quotation, the Court's attention is respectfully invited to the discussion between counsel and the Referee in Volume IV of the Reporter's Transcript, p. 409, line 6, to p. 410, line 13, and again at page 411, line 19, to p. 414, line 10.

Appellants are naturally reluctant to accuse the Referee in this case of actual abuse of his powers. However, Appellants strongly believe and contend that the Federal Courts have plainly announced their policy in this regard. The following summarized cases are submitted herewith in support thereof:

1. *Kaplan v. Guttman* (cited above).

Judge Fee's statement of the law was as follows:

> "Even where the United States Courts have complete jurisdiction, by comity their officers frequently refer controversies to the State Courts, which administer local law, in order to arrive at a solution most compatible with the mores of the community. This was not done here. *Although it might well have been,* no question of abuse of discretion is here considered . . . (Emphasis added.)

2. *Thompson v. Magnolia Petroleum Co.,* 309 U.S. 478 (1940).

A dispute between the Trustee for the bankrupt railroad and Respondent over title to lands. Trustee held a recorded document indicating title in fee and also had possession of the land by virtue of its tracks, usage, etc. Bankruptcy Court took summary jurisdiction. The Supreme Court said summary jurisdiction could lie, but reversed nevertheless:

> "A Court of Bankruptcy has an exclusive and non-delegable *control* over the administration of an estate in its possession. But the *proper exercise* of that control may, where the interests of the estate and the parties will best be served, lead the Bankruptcy Court to consent to submission to State Courts of particular controversies involving unsettled questions of State property law and arising in the course of bankruptcy administration . . . (the) decision with which the Federal Court of Bankruptcy is here faced *calls for interpretation of instruments of conveyance in accordance with Illinois law.*" (and should be decided by Illinois Courts) (Emphasis added).

3. *In re Graceland* (D.C. So. Dist. of Calif., Central Division), 73 Fed. Supp. 158.

Involved a cemetery which had been conveyed by the bankrupt prior to bankruptcy—to the adverse claimants. The Referee had made an order for the Trustee to proceed in the State Court, and when the Trustee nevertheless thereafter sought to obtain summary jurisdic-

tion in the bankruptcy court, the District Judge stated the law:

> "The Referee was quite right in his views. Since the *record title* to the real property was in the third parties who were adverse claimants, the matter was one for the determination of the State Court."

4. *Jackson v. Sports Company of Texas, Inc.* (5th C.C.A.), 278 F. 2d 716.

The bankrupt corporation had owned real property improved with a commercial building. Prior to bankruptcy, the corporation President had deeded the land to himself. *The bankrupt corporation continued in possession of the premises up to and including the date of bankruptcy.* The Trustee brought an action to set aside the transfer and summary jurisdiction was objected to by the Respondent.

The Referee assumed jurisdiction and the District Court affirmed. The Circuit Court reversed, using the following language at page 719:

> "We think that whether the deed from the corporation to appellant was fraudulent and void under the complicated facts in the record should be determined by a plenary hearing on the merits. This holding is supported by the authorities cited and several cases decided by this court."

5. *Martoff v. Elliott* (9th C.C.A.), 326 F. 2d 205.

The bankrupt and his spouse held property as joint tenants, which was rented and occupied by third parties. The Trustee brought action to have the property declared to be community. The spouse objected to summary jurisdiction in the Bankruptcy Court.

The Referee assumed jurisdiction, and on Review the District Court affirmed. On appeal the Circuit Court reversed using the following language at page 208:

> "She (the spouse) is entitled to have the *question of title* decided in a plenary suit if her claim is substantial and not merely colorable. We conclude that she is entitled to a plenary suit. Her claim has enough substance that we think a *state court* should make the *determination as to title.*" (Emphasis added.)

6. *Palmer v. Travelers Ins. Co.,* 319 F. 2d p. 298.

> "The mere fact that the bankruptcy courts do have summary jurisdiction of the property of the bankrupt, and can act expeditiously in the protection of bankrupts' estates, and have significant obligations to creditors' and to bankrupts' debtors to avoid costly and fruitless litigation which might dissipate the bankrupts' estate, should not persuade them to accept obligations which are not, in any ultimate sense, their business. The obligation of the bankruptcy court to determine controversies in relation to the estates of bankrupts should reach only to the merits of controversies between adverse parties properly before it, and to matters of *undoubted jurisdiction.* It should not extend to substantial summary determination on the merits of a cause which should actually be resolved in another forum by plenary action." (Emphasis added.)

POINT FOUR.

Appellants' Adverse Claim to the Property Was Substantial and Not Merely Colorable.

The Referee has signed Findings of Fact to the effect that the claims of Appellants have "no real or substantial merit" [Nos. 58, 59 and 60, Clk. Tr. p. 89]. Although it does not appear the Referee assumed jurisdiction on this basis, it is anticipated that Appellees will contend that such a finding will support summary jurisdiction in the bankruptcy court.

Appellants do not deem it necessary to add to the length of this brief by citing authorities on this point. Suffice it to say that thirteen days of trial is ample to establish that a substantial question of fact and law existed.

POINT FIVE.

Appellant Is Entitled to a Decision on the Merits.

A. The Referee's Decision That the Deed Was a Mortgage Is Not Supported by the Evidence.

For authorities in this regard, we must necessarily look to California law and the most recent leading California case (very similar to the present facts) is *Workman Construction Co. v. Weirick,* 223 Cal. App. 2d 487. At page 492, the court stated:

> "It must appear to the Court *beyond all reasonable controversy* that it was the intention of not only one but all of the parties that the deed should be a mortgage."

The evidence in the case before the Court does not support a finding to this effect.

It displays to the contrary a series of transactions whereby the Debtor Franklin conveyed or offered to convey trust deeds to Appellants all of which were in default or promptly went into default. This was culminated by the so-called Lot 8 apartment house foreclosure by Appellants which gave them record title thereto in fee. The evidence is undisputed that thereafter Appellees offered Appellants a trust deed on the property involved in these proceedings in exchange for title to Lot 8 and Appellants flatly refused this offer. The result of these negotiations then was the outright conveyance of the subject property to Appellants in exchange for a deed to the Lot 8 property, the only other condition being the option to Appellees to repurchase the equity in the subject property.

The Appellants then had refused to accept any further trust deeds from Appellees. Appellees had, according to their own testimony, knowingly executed documents of absolute transfer in fee to Appellants and with the further knowledge that a title policy was being issued thereon based upon their own written representations that it was *not* a security transaction.

In the *Workman* case, cited above, at page 492, the Court further points up the law that:

> "something more than a reservation of the right to repurchase, or a covenant to reconvey, must be shown in order to convert an absolute deed into a mortgage. There is one fact which is indispensable for this purpose . . . it is essential that there be an agreement, either express or implied, on the part of the mortgagor, or someone in whose behalf he executes the mortgage, to pay to the mortgagee a sum of money."

In the present case, the Referee has evidently determined that the option agreement [Debt. Ex. 33] constituted a promise by the Debtors to pay Appellants the sum of $20,500.00. Yet nowhere in the document or in the record is there even a suggestion that there was a promise or agreement to pay such a sum.

The Referee has apparently somehow related this sum to the original judgment indebtedness of the Debtor Franklin to Appellants in the sum of $19,461.81. But the simple unquestioned fact remains that nowhere in the record is there any evidence that the Debtors promised to pay the larger sum or that the original judgment had by some legal means increased to an obligation of $20,500.00.

To the contrary, it is apparent that when Appellants took title to the Lot 8 apartment property by foreclosure, they then held an asset sufficient to satisfy the original obligation, which must necessarily terminate at that point.

In addition, of course, there is to be considered the fact that the option agreement for $20,500.00 did not even run between the Debtors and Appellants. It was granted by Appellants to Curtis W. Reedy who had held the title to the property conveyed to Appellants. Certainly, it cannot be contended that this somehow created an *obligation by Reedy* to Appellants in this sum.

B. The Option Agreement Was Breached and Not Exercised Properly.

The Referee has found as a fact and as a Conclusion of Law that the Debtors complied with the terms of the option agreement and it was *fully* and timely performed.

"courts are strict in holding an optionee to *exact* compliance with the terms of the option".

(*Hayward Lumber & Investment Co. v. Construction Products,* 117 Cal. App. 2d 221).

The Referee here has chosen to ignore the uncontroverted evidence that the Debtors or optionee did not make the trust deed payments and did not pay the taxes when due as the option specifically provided must be done [Rep. Tr. Vol. VII, p. 898, line 23, to p. 899, line 11].

As to the alleged tender by Reedy and/or the Debtors of the re-purchase price of $20,500.00, the method thereof was, to say the least, highly unusual. The alleged tender to Appellant Kapelus was not by the optionee Reedy or even by the Debtors but by an employee of the R. Ala Escrow Company [Rep. Tr. Vol. X, pp. 1214, 1215]. Furthermore, the funds were admittedly *trust funds* held by the escrow company [Rep. Tr. Vol. V, p. 547, line 13, to p. 548, line 17]; and the said escrow company thereafter lost its license after an investigation by State authorities [Rep. Tr. Vol. X, p. 1223, lines 6-12].

It is difficult to conceive that a tender of funds under such circumstances can be interpreted as amounting to "exact compliance with the terms of the option".

C. Appellants Were Prevented From Submitting Evidence on the Case in Chief.

As has been argued previously, the Referee erred in his method of determining summary jurisdiction (Point One A. above). This error was prejudicial to Appellants in that they were thereby effectually prevented from submitting evidence which might otherwise have

swayed the Referee as a trier of fact of the main issues. The trial proceedings were commenced by Appellants on the issue of jurisdiction. They submitted evidence only on title and possession at which point they rested [Rep. Tr. Vol. I, pp. 11-22], under the belief that these were the only pertinent points to be considered on this limited issue. Thereafter the Debtors took over the presentation of evidence and up until the time the Referee made his decision on summary jurisdiction, thirteen trial days later, all of the evidence was submitted by the Debtors and ostensibly only on this limited issue. At the point where the Debtors had rested this issue [Rep. Tr. Vol. XII, p. 1499], the Appellants' counsel was questioned by the Referee as to whether he intended to submit further evidence. But it was impossible for Appellants' counsel to learn from the Referee what factual issues the Referee thought needed to be determined [Rep. Tr. Vol. XII, p. 1501, line 4, to p. 1503, line 25].

It is, of course, true that ordinarily the Court owes no duty to advise counsel of the issues or evidence the Court believes are important or necessary to a case. However, Appellants must contend that under the circumstances here the Referee had erred in his interpretation of the law regarding the issues of summary jurisdiction and Appellants were unable to determine in what direction the Referee had departed.

Hence, the important question before the Court was at that time submitted on only oral argument at the request of the Court [Rep. Tr. Vol. XII, p. 1504, lines 5-10], and decided by him from the bech ten minutes after the close of argument [Vol. XIV, p. 1678].

The Referee's decision *at this point* on summary jurisdiction was obviously based solely on a finding that

the deed was a mortgage [Rep. Tr. Vol. XIV, pp. 1683-1694], and Appellants learned for the first time what factual issues the Referee had been seeking to determine. The confused status of the case at this point may even have caused the Referee to believe the entire case was completed, as is indicated by his statement in Vol. XIV, page 1680, lines 5-13 of the Reporter's Transcript.

But at least it is obvious that some confusion existed in that at this point, on the following day, the *Appellants* were requested to proceed [Rep. Tr. Vol. XV, p. 1712] and only after a bit of discourse were the Debtors persuaded to put on whatever further evidence they had in support of their Application [Rep. Tr. Vol. XV, p. 1718].

Such a misunderstanding is not surprising inasmuch as the Referee had already decided the main issues of the case, and it would obviously be fruitless for Appellants to thereafter present evidence. Certainly we must assume that a Referee is as human as any other trier of fact who has announced his decision from the bench. It is naive to believe that the Referee might, after still more days of trial, "reverse himself" and thus admit that all of the trial time and efforts had been expended for naught.

Or to put it paradoxically, the Referee's decision for the Debtors on the main issues meant to him that he had jurisdiction to hear the matter; by the same token, a final decision for Appellants would have meant that he did not have jurisdiction to hear the case and make such a decision.

What then could the Appellants possibly have hoped to gain by going forward with evidence at this point?

POINT SIX.

On Principles of Equity the Debtors Are Not Entitled to Relief in the Bankruptcy Court.

In examining the record in this case, it is easy to conclude that the Debtors are not before this Court because of a concern for their creditors, unless they have had a sudden change of heart. They have admitted a continuous chain of constant attempts to defraud their creditors by concealing their assets and in general avoiding the payment of their obligations except when inescapably forced to do so. There is testimony by the Debtors that, not only did they conceal all of their real property by having other persons take title thereto, they even banked their funds under someone else's name [Rep. Tr. Vol. XI, p. 1325]. The principal Debtor, Franklin, has been forced to admit that his true name is not Franklin [Rep. Tr. Vol. IV, p. 428], that he has used other names [Rep. Tr. Vol. IV, pp. 467, 468] and that he is a convicted felon [Rep. Tr. Vol. IV, p. 420].

Even their chief witness, Curtis W. Reedy, has admitted that, *at Franklin's request,* he has obtained funds by falsely claiming the Debtor's property as his own [Rep. Tr. Vol. VIII, pp. 938, 939], and that the same tactics were used with other lending institutions [Rep. Tr. Vol. VIII, pp. 948-949].

The Debtors have dealt in fictitious trust deeds, illegally attempted to sub-divide real property, and left a trail of unpaid debts and foreclosed trust deeds from

beginning to end. Their schedules list 27 recorded Abstracts of Judgment and a total of $320,000.00 in unpaid unsecured creditors. It is almost inconceivable that they now have the effrontery to come before a Court of Equity and pray for assistance.

Dated this 22nd day of September, 1966.

Respectfully submitted,

JOHN P. STODD,
Attorney for Appellants.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

JOHN P. STODD

LIST OF EXHIBITS.

Debtors' Exhibits	Marked For Identification	Offered Into Evidence	Admitted Into Evidence
1.	P.	P. 86	P. 86
2.		88	90
3.		96	98
4.		105	105
5.		115	115
6.		121	122
7.		122	122
8.		124	124
9.	142		
10.	142		
11.		143	144
12.		143	144
13.		147	147
14.		148	150
15.		155	155
16.		156	156
17.	158		
18.	164	1375	1375
19.	164	1376	1376
20.		164	164
21.		168	168
22.		169	169
23.		170	170
24.		171	171
25.		171	172
26.		199	199
27.	218		
28.		222	222
29.		224	224
30.		231	231
31.		240	240
32.	242	812	813

Debtors' Exhibits	Marked For Identification	Offered Into Evidence	Admitted Into Evidence
33.		245	245
34.	255	811	811
35.		260	260
36.	280		
37.		281	281
38.	331	285	817
39.	297	817	817 & 1127
40.	298	817	817 & 1127
41.		304	304
42.	310	1167	1167
43.		320	321
44.		324	324
45.		326	327
46.	328	327	828
47.	351	867	867
48.		354	354
49.		354	354
50.	356	1317	1317
51.		358	358
52.		371	371
53.		372	372
54.	376	1319	1319
55.	376	1410	1410 & 1506
56.		378	379
57.		379	379
58.		384	384
59.		387	387

Debtors' Exhibits	Marked For Identification	Offered Into Evidence	Admitted Into Evidence
60.		387	388
61.		391	391
62.		397	397
63.	398		
64.	409		1490
65.	411		1490
66.		544	544
67.		545	545
68.	590	845	845
69.	626	861	861
70.	626	863	863
71.	645	710	710
72.	645	710	710
73.		659	659
74.		698	698
75.			
76.	793	850	850
77.		818	819
78.	824	1019	1020
79.	844	1345	1345
80.		861	861
81.		869	869
82.		869	869
83.		870	870
84.	881	890	891
85.	881	890	891
86.		890	890
87.		1055	1055
88.	1072A	1364	1365
89.	1079	1136	1137
90.		1112	1112
91.		1123	1123
92.		1124	1126

Debtors' Exhibits	Marked For Identification	Offered Into Evidence	Admitted Into Evidence
93.	1135		1136
94.	1138	1335	1335
95.	1140		
96.		1141	1141
97.			1144
98.		1146	1147
99.	1153	1463	1464
100.		1159	1159
101.		1165	1165
102.		1171	1171
103.	1172	1310	1310
104.	1172	1307	1307
105.	1173	1309	1310
106.		1181	1181
107.		1181	1181
108.		1183	1183
109.		1184	1184
110.	1256	1276	1277
111.	1257	1276	1277
112.		1328	1328
113.		1376	1376
114.	1424		
115.		1461	1461
116.	1466	1464	1507
117.	1486	1490	1490
118.		1508	1509
119.	1723		
120.	1735		
121.	1736		

Respondents' Exhibits	Marked For Identification	Offered Into Evidence	Admitted Into Evidence
1.			P. 12
2.	P. 15	P. 13	303
3.	474	1413	1413
4.		479	479
5.	480	1413	1413
6.	556	558	558
7.	970		
8.	1029	1036	1036